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October 14, 2005

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James J. McNulty, Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street
Harrisburg, PA 17105-3265

PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

DOCUMENT
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RE: Joint Application of PECO Energy
Company and Public Service Electric and
Gas Company for Approval of the Merger of
Public Service Enterprise Group
Incorporated with and into Exelon
Corporation
Docket No. A-110550F0160

Dear Secretary McNulty:

Enclosed for filing are an original and nine (9) copies of the Main Brief of the
Office of Consumer Advocate, in the above-referenced proceeding.

Copies have been served on the parties of record as indicated on the enclosed
Certificate of Service.

Sincerely,

James A. Mullins
Assistant Consumer Advocate

Enclosure

cc: Parties of record

Honorable Marlane R. Chestnut, via overnight mail (served October 13, 2005)

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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Joint Application of PECO Energy :
Company and Public Service Electric :
& Gas Company for Approval of : Docket No. A-110550F0160
The Merger of Public Service Enterprise :
Group, With and Into Exelon Corporation :

DOCUMENT
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MAIN BRIEF OF THE
OFFICE OF CONSUMER ADVOCATE

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PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

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Date: October 13, 2005

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I. INTRODUCTION

On February 4, 2005, PECO Energy Company (“PECO”) and Public Service Electric & Gas Company (“PSE&G”)(collectively, “the Joint Applicants”) filed an Application with the Pennsylvania Public Utility Commission (“PUC” or “Commission”) seeking to obtain the approval of the Commission under Chapters 11, 22, and 28 of the Public Utility Code, for the merger of Public Service Enterprise Group (“PSEG”), the corporate parent of PSE&G, with and into Exelon Corporation (“Exelon”), the corporate parent of PECO and the ultimate corporate parent of the Joint Applicants. The Joint Applicants requested that the Commission issue Certificates of Public Convenience for PECO and PSE&G evidencing its approval or that the Commission determine that such approval is not necessary. On March 7, 2005, the Office of Consumer Advocate (“OCA”) filed a Notice of Intervention and Protest in order to ensure that the merger is approved by the Commission only if (1) it is found to be in the public interest; (2) it provides substantial, affirmative benefits to PECO’s ratepayers; (3) it does not adversely affect retail competition in Pennsylvania; and (4) it is in accordance with the Public Utility Code. Petitions to Intervene and/or Protests were filed by 22 other parties and the Office of Trial Staff (“OTS”) entered its appearance in the matter.

A Prehearing Conference was held on March 29, 2005 to establish the schedule for litigation and to address outstanding procedural matters of interest to the parties. In accordance with the procedural schedule the parties conducted extensive discovery, including an informal discovery session and served direct, rebuttal and surrebuttal testimony. By Secretarial Letter dated July 15, 2005, the parties were directed to respond to five Directed Questions submitted by PUC Vice Chairman James H. Cawley and Commissioner Bill Shane. The parties then served Supplemental Testimony in accordance with a revised procedural schedule

addressing the Directed Questions. Also in accordance with the procedural schedule, two public input hearings were held on June 30, 2005.

During the course of this proceeding, the parties undertook settlement discussions. Those discussions have now resulted in a Joint Petition for Settlement (“Joint Petition” or “Settlement”) by some of the parties to the proceeding. The signatory parties to the Joint Petition for Settlement were the Joint Applicants (“PECO” and “PSE&G”), the Office of Trial Staff, the Office of Consumer Advocate, the Office of Small Business Advocate, the Department of Environmental Protection, Senator Anthony Williams, Action Alliance of Senior Citizens of Greater Philadelphia, *et al.*, Citizens for Pennsylvania’s Future, *et al.*, Reinvestment Fund/Sustainable Development Fund, Energy Coordinating Agency, and the Philadelphia Area Industrial Energy Users Group. Although not signatories to the Joint Petition, the Labor parties (Exelon Utility Coordinated Councils, Locals 614 and 777 of the International Brotherhood of Electrical Workers and Frank Kuders) have submitted a letter indicating that they will not oppose the Joint Petition. The OCA respectfully submits that this comprehensive Settlement, joined in by a broad array of diverse interests, fairly resolves the many concerns regarding the merger.

In order for this merger to be approved by the Commission, the merger must provide substantial, affirmative benefits to Pennsylvania consumers and Pennsylvania. City of York v. Pa. PUC, 449 Pa. 136, 295 A.2d 825 (1972). The OCA submits that implementation of the provisions of the Settlement will satisfy this requirement. Among other things, the Settlement provides benefits through rate reductions, extensions of the transmission and distribution rate cap, improved commitments to reliability and customer service, improved universal service programs, commitments to community presence and corporate giving and contributions to renewable energy and economic development. In addition, the Settlement

provides necessary protections for ratepayers regarding the recovery of nuclear costs by PECO and insulates ratepayers from corporate risks through corporate structure and rate of return protections. The Settlement also provides protections for certain of PECO's workforce positions. The Settlement also calls for reporting of PJM wholesale market information so that the Commission and parties can better monitor these markets, and it retains the rights of the signatory parties to participate in the proceedings at the Federal Energy Regulatory Commission ("FERC") regarding appropriate market power mitigation plans. Finally, the Joint Petition calls for a separate fact-finding investigation to examine the issues related to the consolidation of PGW natural gas operations into the natural gas business of Exelon where all issues can be thoroughly explored and all affected parties can participate.

In addition to the Joint Applicants' Application and testimony, numerous Statements in Support of the Settlement have previously been filed with the Commission. Likewise, various pieces of testimony have been admitted into the record. Testimony in support of the settlement was filed by PECO witness Denis O'Brien. See, PECO Statement 1-S. The OCA testimony admitted into the record includes the testimony of Richard LaCapra (OCA St. 1 (Redacted)(Proprietary and Non-Proprietary), OCA St. 1-R, OCA St. 1-S and OCA St. 1-Supp.); the testimony of Jerome D. Mierzwa (OCA St. 3, OCA St. 3-S); and the testimony of Barbara R. Alexander (OCA St. 4, OCA St. 4-S, OCA St. 4-Supp.). Three days of evidentiary hearings were held on issues being pursued by non-signatory parties. The OCA submits that the Application, testimony and Statements in Support provide substantial evidence of record in support of the Settlement. Additionally, the OCA submits that the wide array of parties with a direct and substantial interest in this proceeding and in PECO's service territory have come together to forge a Settlement that is in the public interest and fully in accord with Commission

policy and applicable law. The OCA urges the ALJ and the Commission to approve this comprehensive settlement.

The OCA hereby submits its Main Brief in Support of the Settlement. The OCA's proposed Findings of Fact and Conclusions of Law are attached as Appendix A.

II. ARGUMENT

A. Legal Standards

PECO and PSE&G sought approval of this merger by the Pennsylvania Public Utility Commission pursuant to Sections 1102, 1103, 2210 and 2811 of the Public Utility Code. Section 1102(a) requires that the Commission issue a Certificate of Public Convenience as a legal prerequisite to offering service, abandoning service and certain property transfers by public utilities or their affiliated interests. The statute, in pertinent part, provides:

Upon application of any public utility and the approval of such application by the commission, evidenced by its certificate of public convenience first had and obtained, and upon compliance with existing laws, it shall be lawful:

(3) For any public utility or affiliated interest of a public utility as defined in section 2101 . . . to acquire from, or transfer to, any person or corporation . . . by any method or device whatsoever, including the sale or transfer of stock, including a consolidation, merger, sale or lease, the title to, or the possession or use of, any tangible or intangible property used or useful in the public service.

...

66 Pa.C.S. §1102(a)(3).

To obtain a certificate of public convenience, the merger must be found to be in the public interest. To be found to be in the public interest, the Courts have held that the merger must “affirmatively promote the service, accommodation, convenience or safety of the public in some substantial way.” City of York v. Pa. PUC, 449 Pa. 136, 295 A.2d 825 (1972); Middletown Twp. v. Pa. PUC, 482 A.2d 674, 682 (Pa. Commw. Ct. 1984). See also, Re: DQE, Inc., 88 Pa. PUC 467, 474 (1998); Newtown Artesian Water Company, 76 Pa. PUC 260, 262 (1992). To ensure that a proposed merger is in the “public interest,” the Commission may impose conditions on its granting of the certificate of public convenience. Re: DQE, Inc., 88 Pa. PUC at 474. Section 1103 explicitly allows the Commission to impose conditions upon the

issuance of a certificate of public convenience. 66 Pa.C.S. §1103. Section 1103, in pertinent part, provides:

A certificate of public convenience shall be granted by order of the commission, only if the commission shall find or determine that the granting of such certificate is necessary or proper for the service, accommodation, convenience, or safety of the public. The commission, in granting such certificate, may impose such conditions as it may deem to be just and reasonable.

66 Pa.C.S. §1103(a).

The PECO and PSE&G merger application must also be reviewed pursuant to Section 2811 of the Public Utility Code that was adopted by the General Assembly as part of the Customer Choice Act. Pursuant to Section 2811, the Commission generally has responsibility for “monitor[ing] the market for the supply and distribution of electricity to retail customers and take steps as set forth in this section to prevent anticompetitive or discriminatory conduct and the unlawful exercise of market power.” 66 Pa.C.S. §2811(a). With regard to electric utility mergers, Section 2811(e) specifically requires the Commission to:

... consider whether a proposed merger, consolidation, acquisition or disposition is likely to result in anticompetitive or discriminatory conduct, including the unlawful exercise of market power, which will prevent retail electricity customers in this Commonwealth from obtaining the benefits of a properly functioning and workable competitive electricity market.

66 Pa.C.S. §2811(e)(1). Section 2811(e)(2) requires that upon request for approval of a merger or acquisition, notice and an opportunity for hearing shall be afforded to explore whether a proposed transaction is “likely to result in anticompetitive or discriminatory conduct or the unlawful exercise of market power.” 66 Pa.C.S. §2811(e)(2). The Commission is also authorized to establish terms and conditions that it finds necessary to preserve the benefits of a properly functioning and workably competitive retail electricity market.

Similarly, Section 2210 requires the Commission to consider the impact of a proposed merger on the competitive retail natural gas market. 66 Pa.C.S. §2210. In the exercise of its authority to consider a merger, the Commission is to consider whether the proposed merger is likely to result in anticompetitive or discriminatory conduct, including the unlawful exercise of market power, which will prevent retail gas customers from obtaining the benefits of a properly functioning and effectively competitive retail natural gas market. The Commission is also authorized to impose necessary terms and conditions to preserve the benefits of the properly functioning and effectively competitive retail natural gas market.

Thus, the Commission must review the merger to determine if it is in the public interest, provides substantial, affirmative benefits, and is not likely to result in anticompetitive or discriminatory conduct or the unlawful exercise of market power in the retail electric and natural gas markets. As discussed below, the OCA submits that the Settlement ensures that the merger provides substantial, affirmative benefits to PECO ratepayers and the Commonwealth. Additionally, the Settlement provides the Commission with additional information to monitor issues related to the unlawful exercise of market power, and it allows the signatories to continue to participate in the consideration of appropriate market mitigation plans at FERC.

B. The Settlement Is In The Public Interest, Fully Supported By Substantial Evidence of Record, And Consistent With Pennsylvania Law and Policy.

1. Introduction

The Joint Petition contains numerous provisions that, once implemented, will provide substantial, affirmative benefits to ratepayers and the Commonwealth of Pennsylvania. As OCA witness LaCapra stated, the potential risks and harms to ratepayers from a merger can be many. OCA St. 1 (Redacted) at 8. Witness LaCapra testified:

The potential risks and harms to ratepayers from a merger can be many. They include the risk that the “costs to achieve” a merger might escalate to a degree that overwhelm potential cost savings, the risk that a corporate structure might be implemented that introduces a bias that is adverse to Pennsylvania’s interest, the risk that management attention and expertise might be shifted away from core utility operations, the risk that the pressure to create additional profits or savings might eliminate distribution employees necessary for service quality, the risk of increased capital costs and the risk of capital drain to support other operations. There could be a loss of local control, both at the utility level and at the regulatory level.

Id. at 8-9.

As to this specific merger, OCA witness LaCapra identified a number of potential risks to Pennsylvania ratepayers, including the risk that projected net savings would not accrue to Pennsylvania ratepayers, the risk that costs to achieve could escalate, the loss of Pennsylvania jobs, the risk of reliability and quality of service being degraded, and the risk that corporate and management attention would be diverted from local communities. OCA St. 1 (Redacted) at 10.

As described in the OCA’s Statement in Support of the Settlement, and below, the Settlement provides both protections for PECO’s ratepayers and substantial, affirmative benefits as a means of ensuring that the proposed merger will be in the public interest and in the best interest of PECO’s ratepayers.

2. PECO Ratepayers Will Benefit From Rate Reductions Over Four Years and Extended Rate Cap Protections.

As set forth by OCA witness LaCapra, it appears very likely that this merger will create significant benefits to Exelon’s and PSEG’s shareholders. OCA St. 1 (Redacted) at 10. The Application, however, contained no concrete assurance of delivery of merger savings to PECO ratepayers. See, OCA St. 1 (Redacted) at 17-18. To definitively capture quantifiable savings for ratepayers, the Settlement contains provisions dealing with rate reductions and rate

caps. Specifically, PECO has agreed to reduce its retail electric distribution rates by \$120 million over a four-year period. The rate reductions will commence approximately one month after consummation of the merger. In the first two years, rates will be reduced by \$40 million each year. In the next two years, rates will be reduced by \$20 million in each year.

In addition to the rate reductions, PECO has agreed to cap its transmission and distribution charges through 2010. With this commitment, the period of transmission and distribution rate stability for PECO's customers extends nearly 20 years, since PECO's last base rate case in 1990.

During the rate reduction and extended rate cap period, PECO has also agreed to amortize the costs and expenses of achieving the merger. As OCA witness LaCapra testified, costs to achieve often carry the potential for significant cost overruns, particularly when those costs are associated with the integration of information and communication technologies as in this proposed merger. OCA St. 1 (Redacted) at 15-16. By requiring that all costs to achieve are amortized over the rate reduction and rate cap period, ratepayers will be protected from any cost overruns as well as from having to shoulder any of these costs in future rate cases.

The OCA submits that the rate reductions, along with the extended rate cap and full amortization of the costs to achieve the merger, provides a reasonable and appropriate level of merger savings for PECO ratepayers. This provision secures an important benefit of the merger for ratepayers.

3 The Settlement Confirms That PECO Ratepayers Will Not Bear Nuclear Costs Associated With PSEG's Ownership Share of Nuclear Units.

The Settlement confirms PECO's commitment made in the 2000 Unicom Merger Settlement, and in its testimony here, that PECO's ratepayers will only be responsible for nuclear costs, including nuclear decommissioning costs that are associated with the ownership and

operation of nuclear plants that PECO held on December 31, 1999 (Pre-Existing Nuclear Interests). See, PECO St. 1 at 11. See also, OCA St. 1 (Redacted) at 28. Paragraph 19 of the Joint Settlement ensures that costs from the PSEG plants will not be charged to PECO's ratepayers, and that no portion of PECO ratepayer supplied funding of PECO Pre-Existing Nuclear Interests will be diverted to pay costs associated with acquired plants.

4. The Settlement Provides For A Quality of Service Plan To Maintain Or Improve Reliability and Customer Service Over The 2000 Unicom Merger Commitments.

As stated by OCA witness Alexander, mergers present significant risks to customers that, in the efforts to reduce costs and find savings, measures may be taken that adversely impact customer service and service reliability. OCA St. 4 at 12-13. Although mergers also bring the possibility to share in "best practices" that will improve service to customers, there is no assurance that these best practices will be implemented or deliver the promised benefits to customers. OCA St. 4 at 12-13. In order to minimize these risks and to deliver on the promises of bringing best practices to the delivery of reliable and quality service, PECO has agreed to a Quality of Service Plan. The Quality of Service Plan ("Service Plan") is designed to maintain or improve reliability and customer service provided by PECO over the levels committed to in the 2000 Unicom Merger Settlement.

In the 2000 Unicom Merger Settlement, PECO agreed to a Quality of Service Plan, but that Plan was set to expire at the end of 2005. OCA St. 4 at 23. Through the Joint Petition, PECO has agreed to extend its reliability and customer service commitments through a new Quality of Service Plan. In the Service Plan, PECO has agreed to established performance thresholds in eight areas that are important to providing safe and reliable service and reasonable customer service. These areas are: System Average Interruption Frequency Index ("SAIFI"),

Customer Average Interruption Duration Index (“CAIDI”), Percentage of calls answered within 30 seconds, Average “Busy-Out” rate, Average Call Abandonment rate, Percentage of residential bills not rendered once every billing period, Gas Response Time to Safety Calls and OSHA Lost Work Days Cases.¹ By establishing the Service Plan, the Joint Petition will better ensure that the proposed merger will not result in any service decline, and that service will be improved as best practices are identified and brought into Pennsylvania.²

The Joint Petition also ensures that the Service Plan metrics and thresholds are a part of the annual performance appraisal and compensation for managerial and supervisory employees. This will ensure that management and supervisory personnel are held accountable under the Service Plan.

As to enforcement of the Service Plan, the Joint Petition provides for a process for addressing any performance failures or non-compliance with the Service Plans. Joint Petition at ¶¶ 25-27. This process allows for expedited consideration of any failures by the parties and the Commission. All parties also retain their rights to pursue complaints or other failures not measured by the Service Plan, or to respond to individual or community complaints. It is important to note that the Service Plan does not limit or eliminate PECO’s responsibility to address reliability and customer service problems in its service territory, nor does it limit the authority of the Commission or any of its Bureaus. See, Joint Petition at ¶¶ 28-30.

¹ For a description of each of these metrics, please refer to OCA St. 4 at 26-28.

² PECO has also agreed to a number of reporting requirements that will assist the Commission and the parties in monitoring many aspects of the provision of reliable service as well as quality customer service, each year. See, Paragraph 24. As to reliability, PECO will continue to report on its efforts to improve reliability of its five worst performing circuits each year, its storm management efforts for major storms, its efforts to reduce repeat outages experience by customers, and its SAIDI (System Average Interruption Duration Index) and MAIFI (Momentary Average Interruption Frequency Index). As to customer service, PECO will continue to report on the number of residential customer disputes not issued a Company report in 30 days, its justified consumer complaint rate, its PUC Infraction Rate, the number of residential bills not rendered each month, the number of residential meters not read every month, and its customer satisfaction survey results.

Finally, the Joint Petition sets forth a process to be followed by PECO in informing the Commission and interested parties about its impending billing system conversion. As OCA witness Alexander noted, the move to integrate billing systems can present particular challenges. OCA St. 4 at 23. By agreeing to work closely with the parties, these challenges can be identified and resolved. Importantly, PECO has agreed that if customers are subject to billing errors or billing delays associated with the implementation of the new billing system, customers will be given an opportunity for an affordable payment arrangement without regard to the limitations contained in Chapter 14 of the Public Utility Code. See, Joint Petition at ¶32.

The OCA submits that the Reliability and Customer Service Quality of Service Plan, along with the other reliability and customer service provisions of the Joint Petition will better ensure that the merger does not result in reliability or service declines and that best practices are identified and brought into Pennsylvania. As such, one of the benefits of the proposed merger, the sharing of best practices to maintain and improve reliability and customer service, can be monitored and delivered in Pennsylvania.

5. The Joint Petition Provides Significant Improvements In PECO's Universal Service Programs.

As explained by OCA witness Alexander and OCA witness LaCapra, as management dedicates substantial efforts to merger integration and as the affected companies seek to achieve costs savings, low-income customers can be particularly affected. OCA St. 4 at 12-13, 36; OCA St. 1 at 14. These customers are the most vulnerable to any degradation in service quality and reliability of service, particularly in light of the directives and restrictions with respect to payment arrangements and increased disconnection of service that has already resulted from the implementation of Act 201. OCA St. 4 at 36. Through the Joint Settlement, PECO makes a number of significant commitments that will enhance its universal service

programs as well as the operation of those programs.

Of particular note, PECO has agreed to increase the amount of kilowatthour usage that is subject to the discounted rate for all customer Assistance Program (CAP) Rate participants. Currently, PECO's CAP is a rate discount program where PECO provides eligible customers a discount on the first 500 kwh of usage. OCA St. 4 at 37. Usage above the level is billed to the customer at the regular residential rate. Id. The average usage for a CAP customer, however, exceeds 500 kwh. The average usage for CAP customers is about 632 kwh per month (heating and non-heating customers combined). OCA St. 4 at 37, fn. 20. Through the Joint Petition, PECO has agreed to increase the monthly usage that is the subject to the discount from 500 kwh to 650 kwh, effective January 1, 2007. The OCA anticipates that an increase in the "usage cap" will better assist low-income customers in being able to pay their bills.

PECO has also agreed to increased efforts to reach customers most in need and to efficiently certify customers eligible for participation. PECO has agreed to increase its own efforts and spending on outreach and education. PECO will spend an additional \$1.2 million over the next four years on its outreach and education efforts. PECO has also agreed to provide funding to local community based organizations in the amount of \$100,000 per year for four years to assist PECO in better identifying and reaching eligible households. As OCA witness Alexander noted, there may be "best practices" in effect in New Jersey that can be incorporated into PECO's outreach efforts. OCA St. 4 at 41. PECO has agreed to continue to work with many of the interested parties through its Advisory Committee as these efforts proceed. Joint Petition at ¶ 35.

In addition to its own efforts to enhance its universal service programs, PECO has agreed to provide additional funding through its Matching Energy Assistance Fund ("MEAF")

from 2007 through 2010 to be used by the county agencies in assisting PECO customers. As OCA witness Alexander and Action Alliance witness Geller noted, PECO's contribution levels, and continuing contribution levels to MEAF are of concern. OCA St. 4 at 44; AA St. 1 at 23-26. PECO will provide \$500,000 in additional energy assistance each year to the county fuel fund agencies beyond its current matching of contributions and reimbursement of administrative costs for those agencies. Over the four years, this will provide an additional \$2 million to assist PECO customers with their energy needs.

PECO has also agreed to restore the monthly bill check-off box option for MEAF contribution on customer bills when it implements its new customer billing and information system. The MEAF check-off box option has not appeared on the PECO bill at least since the bill format changed with restructuring. PECO's agreement to restore the check-off box, as well as its agreement to provide for MEAF contributions from electronic bill payment customers, if technically feasible and not substantially uneconomical, should better enable customers to give to MEAF. PECO has also committed to providing bill inserts on MEAF on a regular basis so that customers are fully informed about the program and how to make contributions. In this time of ever-increasing energy prices, and the strain on many household budgets, the importance of these programs, and the ability to easily contribute, can make a significant difference.

The OCA submits that PECO's commitments and improvements to its universal service programs are to be commended. PECO's willingness to provide these significant benefits to low income customers through this proposed merger should assist these customers in being able to afford their energy bills and to receive the necessary help with their bills.

6. The Joint Petition Ensures The Commonwealth Will Benefit From Funding Of Renewable Energy, Energy Efficiency, And Economic Development Initiatives.

As part of the Joint Settlement, PECO has agreed to provide funding for renewable power and energy efficiency initiatives. PECO will provide a total of \$12 million to the Pennsylvania Energy Development Authority (“PEDA”) (\$3 million each year in 2007, 2008, 2009, 2010) to be used for the purpose of funding renewable energy, energy efficiency and energy conservation projects with emphasis on energy conservation projects of benefit to the PECO service territory. Of the \$12 million, a total of \$500,000 (\$125,000 each year in 2007, 2008, 2009, 2010) will be set aside, subject to approval of PEDA’s board of directors, for PEDA qualified Low Income Usage Reduction Programs in PECO’s service territory.

In addition to these amounts, PECO will provide a total of \$8 million to PEDA (\$2 million each year in 2007, 2008, 2009, 2010) to be used for energy-related economic development projects and initiatives of benefit to PECO’s service territory.

PECO has also agreed to continuation of funding of the Sustainable Development Fund (“SDF”). PECO will provide \$7.2 million in a lump sum within three months of the consummation of the merger to be used for projects in accordance with the goals and by-laws of the SDF.

The OCA submits that these commitments will provide benefits to Pennsylvania and to the PECO service territory through the further development of renewable energy and energy efficiency projects, as well as through economic development projects.

7. Numerous Provisions Ensure That Ratepayers Are Insulated From Any Risks Attendant To Non-Jurisdictional Operations.

In the Settlement Agreement for the PECO - Unicom merger, there were several commitments under the category of Corporate Structure protections. The Joint Applicants have

pledged to implement the same protective measures in this merger. PECO St. 1 at 10-11. Specifically, PECO has agreed to a number of corporate protections to ensure that PECO customers will be protected from the risk of affiliated businesses not regulated by the Commission. Joint Petition at ¶¶ 40-48. The corporate protections include provisions regarding accounting and pricing protocols to avoid cross-subsidies and provisions to ensure that the Commission and interested parties have reasonable access to books, records and personnel of affiliates so as to perform regulatory oversight functions. OCA witness LaCapra recognized the need for continuation of these protections. OCA St. 1 at 28-29.

8. The Joint Petition Ensures A Corporate And Community Presence By PECO In Philadelphia And Provides Workforce Staffing Level Protections For Pennsylvania.

As set forth by OCA witness Alexander, due to the various integration plans for the three large electric and gas distribution utilities located in the three different states, as well as the large fleet of generation assets, the potential for lessening the corporate presence and community giving tradition historically in place for PECO can be of concern. OCA St. 4 at 35. Furthermore, as OCA witness LaCapra testified, the merger will have an impact on employment levels within Pennsylvania. OCA St. 1 (Redacted) at 12-14. PECO's employment levels can have an impact on the greater Philadelphia area. OCA St. 4 at 35.

In the Settlement, PECO has made a number of commitments to mitigate these impacts and concerns. First, PECO has agreed to maintain its corporate headquarters for its distribution business in Philadelphia through at least December 31, 2010. Joint Petition at ¶ 49. Second, PECO has agreed that for many of the key workforce positions that affect reliability and customer service, PECO will not reduce certain of its "field forces" prior to January 1, 2011. Joint Petition at ¶51. Further, PECO agreed that it will not reduce workforce positions in

Engineering, Call Center, Revenue Management/Billing, Payment Processing, Design and Construction, Consultant, Energy Technician and Gas Dispatcher as a result of the merger by no more than the number of reductions identified as part of PECO witness Arndt's synergy study produced for this merger proceeding. Joint Petition at ¶51. See also, PECO St. 2. Although PECO is not precluded from sizing its workforce to reflect technological and process improvements that are unrelated to the merger, the Settlement ensures that workforce levels will not be reduced further than projected as a result of the merger.

Finally, PECO has committed to continue its charitable giving and sponsorships at least at its historic level of \$3 million per year each year from 2007 through 2010.

With these commitments, the OCA submits that the Settlement ensures that PECO will maintain a strong corporate presence in Philadelphia and will remain active in the community. These commitments also provide important workforce protections.

9. The Joint Petition Will Provide Information To The Commission To Monitor The Competitive Electric Markets.

PECO has agreed to certain reporting requirements from 2007 through 2012 so that the Commission and the parties can better monitor the PJM wholesale markets. Additionally, the Joint Petitioners retain their rights to participate in the proceeding at the Federal Energy Regulatory Commission ("FERC") regarding appropriate market power mitigation plans. While the signatory parties agreed to no longer pursue market power issues in this proceeding as part of the comprehensive settlement, the Joint Petition does not preclude the right of non-signatory parties to continue to litigate these matters at the Commission. The testimony and hearings on these issues have continued and a record has been developed.

10. The Joint Petition Allows For Consideration Of The Consolidation of PGW With Exelon Natural Gas Operations In Another Forum Where All Affected Parties Can Fully Participate.

The Joint Petitioners have agreed to the initiation of a separate fact-finding investigation after the consummation of the merger to examine the issues related to the consolidation of Philadelphia Gas Works (“PGW”) operations into the natural gas business of Exelon. This process would allow consideration of this issue to continue in a forum where the myriad of issues can be thoroughly explored, where all affected parties can fully participate, and where a reasoned decision can be reached on the issues. As OCA witness LaCapra stated, a great deal of due diligence, financial analysis, and physical assessment is necessary in order to address the relevant issues. OCA St. 1-Supplemental at 9. For example, OCA witness LaCapra listed the following questions as among those which will need to be addressed:

- What is the timeframe and investment required to bring Philadelphia Gas Works to the service level of PECO Energy and PSEG gas operations?
- What is the potential for the LNG facility and how are any costs associated with the facility being treated for ratemaking purposes?
- What is a reasonable rate path for the emerged company, i.e., should there be a uniform rate for each class throughout the service territory and what rate changes are appropriate in the short term?
- What synergies are available to the emerged company and how much of those savings could mitigate the revenue requirement of PGW?
- What are the relative costs and benefits, including benefits of municipal operation versus investor owned operation?
- What are the potential environmental issues with each company?
- What other impacts might there be on ratepayers, such as in billing, collection, safety, or provision of universal service programs?
- How many jobs will be lost in Philadelphia?
- Can the emerged company improve the storage gas profits and to what extent?

- Are there quantifiable net benefits to Pennsylvania?

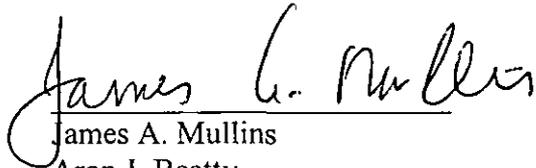
Id. Likewise, OCA witness Alexander listed the following areas which will be in need of consideration: Billing System and Billing Policies, Credit and Collection Policies, Universal Service Programs and Policies, Customer Education and Quality of Customer Service. OCA St. 4-Supplemental at 2-5.

The investigation proposed by the Joint Petition will ensure that such questions are raised, thoroughly considered, and that all affected parties are afforded a full opportunity to participate.

III. CONCLUSION

For the reasons set forth above, and the reasons set forth in the Joint Petition and the OCA's Statement in Support, the OCA submits that the Settlement reaches a fair balance of the large number of issues and interests in this proceeding. This comprehensive Settlement is the product of intense and detailed negotiations that brought together a wide array of diverse parties. The Settlement brings substantial affirmative benefits to PECO ratepayers and Pennsylvania. *The Settlement is in the public interest and should be approved.*

Respectfully submitted,



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Dated: October 13, 2005
86056

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Joint Application of PECO Energy :
Company and Public Service Electric :
& Gas Company for Approval of : Docket No. A-110550F0160
The Merger of Public Service Enterprise :
Group, With and Into Exelon Corporation :

APPENDIX A TO THE
MAIN BRIEF OF THE
OFFICE OF CONSUMER ADVOCATE

FINDINGS OF FACT

1. PECO will reduce its retail electric distribution rates by \$120 million over a four-year period.
2. PECO will cap its transmission and distribution charges through 2010.
3. PECO ratepayers will only be responsible for nuclear costs, including nuclear decommissioning costs, that are associated with the ownership and operation of nuclear plants that PECO held on December 31, 1999.
4. PECO will implement a Quality of Service Plan designed to maintain or improve reliability and customer service provided by PECO over the levels committed to in the 2000 PECO/Unicom Merger Settlement.
5. PECO will provide a total of \$12 million to the Pennsylvania Energy Development Authority--\$3 million in 2007, 2008, 2009 and 2010--to be used for the purpose of funding renewable energy, energy efficiency and energy conservation projects.
6. PECO will provide \$8 million to the Pennsylvania Energy Development Authority--\$2 million in 2007, 2008, 2009 and 2010—to be used for energy-related economic development projects and initiatives.
7. PECO will maintain its corporate headquarters for its distribution business in Philadelphia through at least December 31, 2010.
8. For many of the key workforce positions that affect reliability and customer service, PECO will not reduce forces prior to January 1, 2011. If any reductions are necessary (as a result of the merger), such reductions will not exceed the number of reductions identified as part of this merger proceeding.

9. PECO will continue its charitable giving and sponsorships in an amount of \$3 million per year from 2007 through 2010.
10. PECO will adhere to certain reporting requirements from 2007 through 2012 in order to facilitate PJM wholesale market monitoring.

CONCLUSIONS OF LAW

1. Based on the Joint Settlement, the Commission's approval of the proposed merger will affirmatively promote the public interest, service, accommodation, convenience, or safety of the public in a substantial way. See, City of York v. Pa. P.U.C., 449 Pa. 136, 295 A.2d 825 (1972).

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PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

Joint Application of PECO Energy :
Company and Public Service :
Electric and Gas Company for : Docket No. A-110550F.0160
Approval of the Merger of Public :
Service Enterprise Group Incorporated :
with and into Exelon Corporation :

I hereby certify that I have this day served a true copy of the foregoing document, the Main Brief of the Office of Consumer Advocate, upon parties of record in this proceeding in accordance with the requirements of 52 Pa. Code § 1.54 (relating to service by a participant), in the manner and upon the persons listed below:

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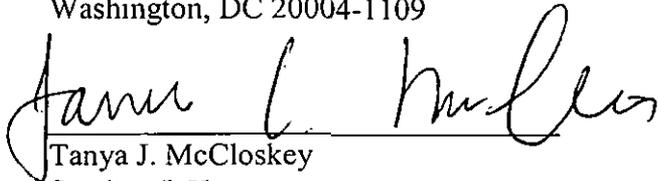
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October 14, 2005

Via Hand delivery

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DOCUMENT
FOLDER

Re: Joint Application of PECO Energy Company and Public Service Electric
and Gas Company for Approval of the Merger of Public Service
Enterprise Group Incorporated with and into Exelon Corporation
Docket No. A-110550F0160

Dear Secretary McNulty:

Enclosed herewith for filing on behalf of Metropolitan Edison Company, Pennsylvania Electric Company, Pennsylvania Power Company and FirstEnergy Solutions Corp. are an original and nine (9) copies of the Main Brief. Also enclosed is a disk in Word containing the Main Brief.

I have served copies of this document on all parties to this proceeding as shown on the attached Certificate of Service. The Administrative Law Judge will receive a disk containing the Main Brief in Word version, in addition to a hard copy, via hand delivery today.

Respectfully submitted,

RYAN, RUSSELL, OGDEN & SELTZER LLP


W. Edwin Ogden

RECEIVED
SECRETARY'S BUREAU
OCT 14 PM 12:33

Enclosures
WEO:jab

c: The Honorable Marlane R. Chestnut (via Hand Delivery)
Per Certificate of Service

32

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

JOINT APPLICATION OF PECO ENERGY COMPANY
AND PUBLIC SERVICE ELECTRIC AND GAS
FOR APPROVAL OF THE MERGER OF
PUBLIC ENTERPRISE GROUP INCORPORATED
WITH AND INTO EXELON CORPORATION

DOCKET NO. A- 110550F0160

DOCUMENT
FOLDER

MAIN BRIEF
ON BEHALF OF
FIRSTENERGY COMPANIES

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DOCKETED
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Date: October 14, 2005

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I. Statement of the Case

A. Introduction

PECO Energy Company ("**PECO**") and Public Service Electric and Gas Company ("**PSE&G**") commenced this Pennsylvania Public Utility Commission ("**Commission**") proceeding in order to obtain the Commission's approval of the merger of Public Service Enterprise Group Incorporated with and into Exelon Corporation (the "**Proposed Merger**"). PECO and PSE&G also are referred to, collectively, as the "**Applicants**".

The Proposed Merger proceeding is pending before The Honorable Marlane R. Chestnut (the "**ALJ**").

This Main Brief is submitted on behalf of Intervenor Metropolitan Edison Company ("**Met-Ed**"), Pennsylvania Electric Company ("**Penelec**"), Pennsylvania Power Company ("**Penn Power**") and FirstEnergy Solutions, Corp. ("**FES**"). These parties also are referred to, collectively, as the "**FirstEnergy Companies**".

The FirstEnergy Companies have a direct and substantial interest in assuring that the Proposed Merger does not adversely affect competition in the supply of power to serve retail customers in Pennsylvania. Met-Ed, Penelec and Penn Power are Pennsylvania electric distribution companies that provide retail electric distribution service and provider of last resort ("**POLR**") electric generation service to customers, pursuant to Chapter 28 of the Public Utility Code, also known as the Electricity Generation Customer Choice and Competition Act, 66 Pa. C. S. §§ 2801-2812 ("**Electric Competition Act**"). FES is a licensed electric generation supplier under the Electric

Competition Act, and currently provides wholesale and retail energy to customers in Pennsylvania and in the PJM Interconnection (“PJM”) market generally.

B. FirstEnergy Companies' Market Power Concerns

This Main Brief addresses the following market power concerns, which have been preserved for disposition by the ALJ, and the Commission, pursuant to a Stipulation Regarding Market Power Issues among the Applicants and the FirstEnergy Companies filed on September 22, 2005 (“Stipulation”).

1. Absent a plan sufficient to mitigate market power consequences of the Proposed Merger, is the Proposed Merger likely to have a material adverse impact on the competitive retail electricity market in Pennsylvania? (Yes. The Applicants' evidence concedes this point. Unrefuted expert testimony from the FirstEnergy Companies also establishes this point.)

2. Do the Applicants bear the burden of proof, in this Commission proceeding, to establish that the proposed market power mitigation plan they have offered is sufficient to remedy the admitted adverse market power consequences of the Proposed Merger, which threaten the competitive retail electricity market in Pennsylvania? (Yes. The Electric Competition Act and related Pennsylvania law require that Applicants meet this burden of proof.)

3. Have the Applicants provided the Commission with a substantial evidentiary basis from which to conclude that the Applicants' proposed market power mitigation plan is sufficient to remedy the admitted adverse market power consequences of the Proposed Merger, which threaten Pennsylvania's competitive retail electricity market? (No. There is no substantial evidence in this proceeding that could support such a conclusion. The sufficiency of the Applicants' plan remains unresolved.)

C. History of the Proceeding

The ALJ has compiled a general procedural history of the proceeding for purposes of her decision, and has offered that parties need not duplicate that portion of the otherwise required briefing.

II. Summary of Argument

The Electric Competition Act and related Pennsylvania law governing this Commission's approval of mergers require that the Commission, as part of this proceeding, consider whether the Proposed Merger is likely to result in anticompetitive conduct adversely impacting the competitive retail electricity market, thus preventing Pennsylvania's retail electricity consumers from obtaining the benefits of retail electricity market competition established by the Electric Competition Act.

As documented below, the Applicants' own evidence in this proceeding as well as unrefuted expert testimony from the FirstEnergy Companies, among others, establish that the Proposed Merger raises serious market power issues that must be addressed by mitigation steps that are sufficient to remedy the Proposed Merger's adverse competitive retail electricity market consequences. Otherwise, the Commission cannot discharge its statutory obligation to preserve Pennsylvania's competitive retail electricity market, and therefore is not permitted to approve the Proposed Merger.

Thus, in meeting their burden of proof in this proceeding, the Applicants were required to establish a market power mitigation plan sufficient to remedy the adverse market power consequences of the Proposed Merger. The Applicants have not produced sufficient evidence to meet this burden. To the contrary, what should constitute sufficient market power mitigation in the context of the Proposed Merger remains unresolved at this point. Absent a definitive resolution of that critical issue, the Commission cannot discharge its statutory obligation to preserve Pennsylvania's competitive retail electricity market, and therefore cannot approve the Proposed Merger.

III. Argument

A. Applicable Legal Standards

The Commission is required by the Electric Competition Act to consider the Proposed Merger's anticompetitive effects and possible adverse impacts on Pennsylvania's competitive retail electricity market. The Electric Competition Act provides, as follows, at 66 Pa. C.S. § 2811:

§ 2811. Market power remediation

(e) Approval of proposed mergers, consolidations, acquisitions, or dispositions.

(1) In the exercise of authority the commission otherwise may have to approve the mergers or consolidations by electric utilities or electricity suppliers, or the acquisition or disposition of assets or securities of other public utilities or electricity suppliers, the commission shall consider whether the proposed merger, consolidation, acquisition or disposition is likely to result in anticompetitive or discriminatory conduct, including the unlawful exercise of market power, which will prevent retail electricity customers in this Commonwealth from obtaining the benefits of a properly functioning and workable competitive retail electricity market.

(2) Upon request for approval, the commission shall provide notice and an opportunity for open, public evidentiary hearings. If the commission finds, after hearing, that a proposed merger, consolidation, acquisition or disposition is likely to result in anticompetitive or discriminatory conduct, including the unlawful exercise of market power, which will prevent retail electricity customers in this Commonwealth from obtaining the benefits of a properly functioning and workable competitive retail electricity market, the commission shall not approve such proposed merger, consolidation, acquisition or disposition, except upon such terms and conditions as it finds necessary to preserve the benefits of a properly functioning and workable competitive retail electricity market.

Pursuant to these statutory requirements, the Commission "shall not" approve the Proposed Merger except upon such terms and conditions as are necessary to protect Pennsylvania's competitive retail electricity market.

The Commission's statutory authority and obligations under this portion of the Electric Competition Act are consistent with its general authority to approve mergers if they are proven to be "necessary or proper for the service, accommodation, convenience, or safety of the public." 66 Pa. C.S. § 1103(a). In York v. Pennsylvania Public Utility Commission, 295 A.2d 825 (Pa. 1972), the Pennsylvania Supreme Court held that the Commission approval of a merger should not be granted "unless the Commission is able to find affirmatively that public benefit will result from the merger." York at 449 Pa. 141. It is also well-established that, in deciding whether a proposed merger is in the public interest, the Commission "may impose such conditions as it may deem to be just and reasonable." 66 Pa. C.S. § 1103(a).

Pennsylvania Public Utility Code Section 332(a) sets forth the general rule with respect to burden of proof in proceedings before this Commission:

§ 332. Procedures in general

(a) BURDEN OF PROOF. Except as may be otherwise provided in Section 315 (relating to burden of proof) or other provisions of this part or other relevant statute, the proponent of a rule or order has the burden of proof.

66 Pa. C.S. § 332(a). (Section 315 relates to proceedings not relevant to this case.)

As the parties seeking a rule or order from this Commission, the Applicants bear the ultimate burden of persuading the Commission, by a preponderance of substantial evidence, that the relief sought is proper and justified under the circumstances. Se-Ling Hosiery v. Margulies, 70 A.2d 854 (Pa. 1954).

The Commission's decision must be supported by substantial evidence in the record – i.e., relevant evidence that a reasonable mind may accept as adequate to support a conclusion: more is required than a mere trace of evidence or a suspicion of the existence of a fact sought to be established. See e.g., Section 704 of the Administrative Agency Law, 2 Pa. C.S. § 704; Yellow Cab Company v. Pa.P.U.C., 524 A.2d 1069 (Pa. Cmwlth. 1987); Murphy v. PA Department of Public Welfare, White Haven Center, 480 A.2d 382 (Pa. Cmwlth. 1984); Erie Resistor Corp. v. Unemployment Comp. Bd. of Review, 166 A.2d 96 (Pa. Super. 1961).

B. Discussion of Market Power Evidence

1. Applicants' Evidence Leaves Pending Market Power Concerns Unresolved

The Applicants' witnesses addressing the adverse market power consequences of the Proposed Merger were Denis P. O'Brien, President of PECO Energy Company (PECO Statement No. 1 and PECO Statement No. 1-R); and, William H. Hieronymus, a Vice President of Charles River Associates Incorporated, who was retained by the Applicants as an independent expert to address the potential competitive impact of the Proposed Merger. (PECO Statement No. 3 and PECO Statement No. 3-R).

(a) O'Brien Testimony

When asked in written direct testimony how the Proposed Merger will affect the further development of competitive retail electric and natural gas markets in Pennsylvania, Mr. O'Brien acknowledged that he is not an expert on competition, and deferred to the testimony of Dr. Hieronymus. (PECO Statement No. 1, page 12). However, in his written rebuttal testimony, Mr. O'Brien ventured an opinion that “nearly” all of the competitive market power analyses and arguments presented by parties

opposing the Proposed Merger were reviewed and rejected in a recently issued Federal Regulatory Commission Order ("**FERC Order**") that he generally characterized as "approving the merger and proposed mitigation plan". (PECO Statement No. 1-R, page 15). Mr. O'Brien was incorrect. The subject FERC Order¹ referenced by Mr. O'Brien did not unconditionally "approve" the Proposed Merger. Indeed the FERC Order requires the merger applicants to submit a compliance filing following completion of their proposed divestiture providing a specific "Appendix A" analysis of the Proposed Merger's effect on competition in energy and capacity markets given the actual plants divested and the actual acquirors of the divested assets. If this analysis shows that the Proposed Merger's harm to competition has not been sufficiently mitigated, the merger applicants must propose additional mitigation at that time.²

Furthermore, Mr. O'Brien overlooked testimony from the FirstEnergy Companies that remains unrefuted concerning their significant and lingering market power concerns with the Proposed Merger. (The FirstEnergy Companies' evidence on these points is discussed below.)

(b) Hieronymus Testimony

On behalf of the Applicants, Dr. Hieronymus conducted an analysis of the market power impacts of the Proposed Merger. Dr. Hieronymus admitted in his written direct testimony that the Proposed Merger, absent mitigation, would "raise serious market power issues". (PECO Statement No. 3, page 3).

Dr. Hieronymus based his written direct testimony in this Commission proceeding on his analysis conducted for purposes of the FERC's proceeding with respect

¹ Docket No. EC05-43-000, Order of July 1, 2005, 112 FERC ¶ 61,011 (2005).

² FERC Order, ordering paragraph (G).

to the Proposed Merger. (Id., page 2; Exhibit WHH-1). Based on this analysis, *and assuming the adequacy of the initial market power mitigation plan proposed by the Applicants*, Dr. Hieronymus concluded initially that the Proposed Merger will not have adverse effects on retail electric competition. (Id., pages 3, 9). Similarly, the testimony submitted on the Applicants' behalf at the FERC by Dr. Hieronymus initially concluded that *once the proposed mitigation is taken into account*, the Proposed Merger does not raise competitive concerns. (Exhibit WHH-1, page 3).

Dr. Hieronymus subsequently filed supplemental FERC testimony that relied on expanded market power mitigation commitments of the Applicants to support his opinion, *i.e.*, beyond what Dr. Hieronymus relied on in providing his initial opinion to this Commission and to the FERC. (PECO Statement No. 3-R, page 5). Likewise, in his written rebuttal testimony submitted in this Commission proceeding, Dr. Hieronymus amended his prior analysis (which he had initially advocated this Commission should accept) and, instead, argued that his supplemental testimony (and related additional market power mitigation efforts) should be the basis for this Commission's consideration of market power issues and the discharge of the Commission's statutory obligation to ensure that Pennsylvania's retail competitive market is not adversely impacted by the Proposed Merger. (Id.).

The reassurances of Dr. Hieronymus as to the validity of his original and revised analyses, and his ultimate recommendation (on page 3 of his written rebuttal) that the Commission should find that the Proposed Merger "does not have a competitive effect on relevant markets and will not impede the ability of Pennsylvania consumers to benefit from competitive markets", ring hollow in view of the record in this proceeding.

First, the Applicants must complete further analyses at the FERC before that agency is prepared to sign off on the competitive effects of the Proposed Merger. Moreover, Dr Hieronymus has admitted, as part of his rebuttal testimony in this Commission proceeding, the possibility that further analyses might demonstrate that there are indeed lingering market power concerns that need to be addressed. (Id., pages 2-3). Thus the Applicants' own evidence reveals uncertainty as to whether the market power mitigation plan offered by the Applicants would adequately address what has been admitted to be serious market power issues related to the Proposed Merger.

The recommendation from Dr. Hieronymus flies directly in the face of the FERC's Order imposing additional requirements on the Applicants to affirmatively show no adverse impact on competition; and, if accepted, would result in this Commission providing approval for the competitive impacts of a merger that as yet have not been finally approved at the FERC. The Commission cannot, and should not be asked to, approve the Proposed Merger in such a vacuum.

(c) Joint Petition for Settlement

The Applicants and the FirstEnergy Companies have agreed, pursuant to the Stipulation, that FirstEnergy's market power issues have not been specifically addressed by the Joint Petition for Settlement filed on September 13, 2005 on behalf of the Applicants and a number of other parties ("**Joint Petition**").

The only terms of the Joint Petition that in any manner address competitive electric markets provide for PECO to issue annual reports addressing PJM wholesale market trends, and reserve other signatories' statutory rights and an opportunity to participate in the further FERC efforts to determine whether the Applicants' market power mitigation plan is sufficient to curb the adverse competitive impacts of the

Proposed Merger. (Joint Petition, pages 29-30). These provisions only serve to highlight what remains unresolved in this proceeding; namely, the sufficiency of the Applicants' market power mitigation plan.

2. Substantial Evidence From the FirstEnergy Companies Documents Critical Unresolved Market Power Concerns

The FirstEnergy Companies' witnesses on the market power issues related to the Proposed Merger were William D. Byrd, Director of Rate Strategy for the FirstEnergy Companies (Met-Ed/Penelec/Penn Power Statement No. 1; Met-Ed/Penelec/Penn Power Statement No. 1-S-1); Richard A. D'Angelo, Manager-Rates and Regulatory Affairs-Pennsylvania for the FirstEnergy Companies (Met-Ed/Penelec/Penn Power Statement No. 2); and, Julia Frayer, Managing Director of London Economics International LLC (Met-Ed/Penelec/Penn Power Statement No. 3; Met-Ed/Penelec/Penn Power Statement No. 3-S). The FirstEnergy Companies retained Ms. Frayer as an independent consultant to conduct a detailed analysis of the economic and market power related aspects of the Proposed Merger; and, in particular, the mitigation steps recommended by Dr. Hieronymus on behalf of the Applicants. The FirstEnergy Companies' testimony, which is briefly summarized below, documents the critical market power concerns that remain unresolved with respect to the Proposed Merger.

(a) Byrd Testimony

Mr. Byrd's almost thirty years of experience in the electric utility industry has primarily involved utility economic, analytical and procurement activities. (Met-Ed/Penelec/Penn Power Statement No. 1, pages 1-2). Mr. Byrd testified that the Proposed Merger will result in increased concentration in the various wholesale markets on which Met-Ed, Penelec and Penn Power will rely in order to secure power supplies to

fulfill their POLR obligations. This increased concentration creates the potential for the exercise of market power which could translate into embedded, higher risk premiums in the prices at which future power supplies will be made available to the utilities. (Id., pages 4,8).

Mr. Byrd testified that, while a competitive wholesale market with price transparency and a high degree of liquidity is a necessary condition for a viable, competitive retail market place, perhaps more importantly, and more subtly, it is the *perception* of the competitive wholesale market place which should be of concern (Id., page 7). Potential suppliers will seek to be adequately compensated for the risks they *perceive* they will be incurring by entering into supply arrangements. Participants which enter into transactions in a marketplace that is structurally characterized by some participants having the potential for the exercise of market power will perceive this as a risk exposure; and, either incorporate this risk premium into their prices or require contractual terms which allocate the risks to the purchasing utilities. Either way the POLR customers will ultimately pay a higher price than otherwise. (Id., pages 7-8).

Mr. Byrd pointed out that, although short-term pricing impacts will be borne by the utilities supplying POLR service because of retail price caps, with the expiration of those caps – at the end of 2006 for Penn Power and the end of 2010 for Met-Ed and Penelec – the dynamics of the wholesale market will be reflected in the prices paid by retail customers. (Id., page 4). Mr. Byrd also testified that, given experience with recent auctions in Ohio and New Jersey, it is safe to assume that the companies would be confronted with procurement costs well in excess of existing price caps. (Id., page 7).

Mr. Byrd clarified that he was not offering an opinion on the future level of prices. Whether future electricity price levels are higher or lower than historical levels will be determined by a variety of factors including, but not limited to, fuel prices, the institutional structures within which the industry operates, economic growth, environmental rules and laws, transmission investment. What concerns the FirstEnergy Companies is that whatever the level of future prices, the Proposed Merger would result in higher prices, due to the increased concentration of supply and the perceptions of the increased ability for the merged entity to exercise market power. (Id., page 9).

Not all of the FirstEnergy Companies' concerns about the potential exercise of market power resulting from the Proposed Merger were addressed by the FERC Order. (Met-Ed/Penelec/Penn Power statement No. 1-S-1, page 9). In particular, the FirstEnergy Companies have continuing concerns that the Proposed Merger will drive up electricity prices. (Id.). But, Mr. Byrd emphasized that the FERC did *not* reject the need for further market power analyses of the Proposed Merger. To the contrary, the FERC has concluded that the impact on competition cannot be determined until some future date at which the Applicants' specific divestiture plans become known. Just as importantly, the FERC has retained the right to order additional mitigation if the Applicants' divestiture plans prove to be inadequate. (Id., page 10).

(b) D'Angelo Testimony

The FirstEnergy Companies' witness Richard A. D'Angelo focused on the continuing POLR responsibilities of the FirstEnergy Companies, particularly Met-Ed and Penelec following their generation asset divestiture and the flow-through to their customers of all of their net proceeds from these sales. This testimony provided a summary background and an additional context within which the Commission should

view the concerns and recommendations the FirstEnergy Companies have about the potential market power impact of the Proposed Merger. As Mr. D'Angelo testified, the Commission approved the divestiture of Met-Ed's and Penelec's generation assets as in the public interest anticipating that a vibrant competitive market for retail electric generation competition would develop. However, the robust competitive bidding process that was envisioned at the time of the Commission's approval of the Met-Ed/Penelec restructuring plan never materialized. (Met-Ed/Penelec/Penn Power Statement No. 2, pages 1-10).

This failure is indicative of the broader problems in obtaining robust retail competitive shopping in Pennsylvania's retail generation market. Since current retail rate caps do not permit a true reflection of wholesale market prices, many competitive suppliers generally have avoided the Pennsylvania retail market.³

Mr. D'Angelo testified that high wholesale prices that translate into high retail prices can only be exacerbated by concentration of generating assets. (*Id.*, page 10). Met-Ed/Penelec Exhibits RAD-1 through RAD-3 demonstrate that the costs of supplying energy and capacity have been steadily rising while rates have remained fixed. These cost pressures will continue as wholesale market prices continue to rise.

Although Mr. D'Angelo's testimony focused on the impact of the wholesale market on costs experienced by the FirstEnergy Companies (and, ultimately, their retail customers), retail customers across Pennsylvania, in all regulated service territories, would be harmed by an unwarranted concentration of generation assets which is not in the public interest. It is the Commission's obligation to ensure that the

³ Green Mountain Energy announced this week that it is leaving the Pennsylvania retail market given current market conditions and rules of deregulation. Pittsburgh Post-Gazette October 12, 2005.

Applicants' post-merger market power and the anticompetitive effects of the Proposed Merger will be adequately mitigated.

(c) Frayer Testimony

As an expert economist, Ms. Frayer addressed the relationship between the wholesale electricity market, governed by the FERC, and retail electricity market competition in Pennsylvania. (Met-Ed/Penelec/Penn Power Statement No. 3, page 4). She described the explicit interconnection between the deregulated wholesale market and a vibrant retail electricity market. Under a fully deregulated market structure, the energy component in competitive retail tariffs is directly derived from appropriate regional wholesale market price indications. As such, any impact that increased market power has on regional wholesale price developments will flow through to retail consumers who are exposed to a fully deregulated retail market. (Id., pages 4-5)

Ms. Frayer pointed out that, currently, the link between wholesale and retail electricity markets has been severed for most electricity consumers in Pennsylvania through the imposition of the generation rate caps. The caps on the generation component of the retail tariff insulate POLR ratepayers from the actual cost of electricity in the wholesale market. Moreover, the fixed generation rate caps in today's relatively high priced electricity environment have dampened the potential for full-fledged retail electricity competition in many service territories in Pennsylvania. Many competitive retailers have not been able to develop a foothold in the Pennsylvania market as their costs of operation, based on wholesale market price levels for energy, capacity, and ancillary services that they must purchase, exceed the generation rate caps that the consumers can choose to take advantage of through POLR service. Ultimately, retail electric consumers in Pennsylvania are going to be confronted with an exposure to actual

wholesale price dynamics in the post-rate cap environment. Ms. Frayer warned that a price shock is possible if the post-transition pricing continues to escalate and, particularly, if potential market power is not mitigated at the earliest opportunity; and, urged that the Commission fully consider the Proposed Merger's impact on retail electricity markets as affected by the wholesale market both in the near future, and over the longer term. As generation rate caps expire over the next five years, POLR service will be recalibrated based on then future wholesale market conditions. Utilities will continue to provide services and meet their default supply obligation. However, retail consumers will no longer be insulated from wholesale market dynamics. The retail customers will thus pay for electricity services consistent with wholesale market conditions at that time. (Id., pages 10-12).

Ms. Frayer also pointed out that Met-Ed, Penelec and Penn Power together serve electric consumers representing over 22% of Pennsylvania's electricity demand. (Id., page 9)

The price impact of the explicit re-linking of the retail and wholesale electricity markets will depend on price developments in the wholesale market for electricity, capacity, ancillary services, and other components of the full requirements service that small customers will seek out. Currently wholesale electricity prices are higher than the generation rate cap. Future wholesale price development will depend on fuel prices, the level of competition in the region, and other factors. Given the current level of gas and coal prices, and the forecasts for these fuels for the next few years, it is unlikely that Pennsylvania utilities (and, ultimately, their retail customers) will see a significant drop in electricity prices over the short term. (Id., pages 12-13).

Having set forth the context within which market power issues should be considered in this proceeding, Ms. Frayer conducted a thorough review of the analysis and conclusions initially presented on behalf of the Applicants in the Hieronymus testimony and exhibits submitted in this proceeding. She also conducted an independent analysis of the market power potential resulting from the Proposed Merger, and evaluated the Applicants' market power mitigation plan in the context of these analyses. (Id., pages 14- 16). Met-Ed/Penelec/Penn Power Exhibit 3-A contains the details of Ms. Frayer's analysis and recommendations. Following the Applicants' submission at the FERC of supplemental testimony from Dr. Hieronymus addressing additional market power mitigation steps the Applicants are proposing, Ms. Frayer conducted a further detailed analysis of that supplemental testimony, and submitted further recommendations. (Id., pages 15-16). Met-Ed/Penelec/Penn Power Exhibit 3-B contains her further analysis and recommendations.

Ms Frayer concluded that market power created by the Proposed Merger, if left unchecked, would lead to even higher wholesale prices and ultimately impose a further economic burden on ratepayers to the detriment of a competitive and stable long run market for electricity. She expressed concern that, if the Applicants' potential market power is not fully mitigated, Pennsylvania customers coming off the generation rate cap may face higher retail prices (as a result of wholesale market conditions) than they would have had to endure if the merger had not occurred. (Id., pages 12-13).

Given the magnitude of the post-merger market power in PJM that will result from the Proposed Merger, Ms. Frayer concluded that the revised mitigation plan offered by the Applicants is insufficient. (Id., page 16). As a result of Ms. Frayer's

review and analysis, she recommended several additional mitigation steps that would be appropriate for the Commission to consider. Among them was a recommendation to increase the amount of generation assets the Applicants actually would divest (as opposed to a "virtual" divestiture proposed by the Applicants). (Id., page 17).

In her surrebuttal testimony, Ms. Frayer pointed out that, although she and Dr. Hieronymus continue to disagree about certain details of their respective analyses of the market power impact of the Proposed Merger, one fundamental and important point she made in her original testimony, which the FERC Order has recognized and addressed, was glossed over and mischaracterized in the rebuttal of Dr. Hieronymus. (Met-Ed/Penelec/Penn Power Statement No. 3-S, pages 2-4). Ms. Frayer had made the point in her direct testimony (both in this Commission proceeding and at the FERC) that the Proposed Merger cannot be shown definitively to be in the public interest until the specific units of the Applicants to be divested are known and their purchasers are known. (Id.) The FERC Order agreed with this conclusion, and has specifically provided that agency with a further opportunity to look at the proposed merger in light of the actual results of the Applicants' divestiture activities. Yet, Dr. Hieronymus has continued to recommend that this Commission approve the merger unconditionally, without the benefit of any further review *as required* by the FERC Order. (Id.).

Ms. Frayer pointed out that (consistent with the overriding concerns expressed in her testimony), the merger applicants are required to make a compliance filing to the FERC within 30 days of the completion of their divestiture, providing a complete analysis of the Proposed Merger's effect on competition in energy and capacity markets, given actual plants divested and the actual acquirers of the divested assets and

energy contracts from virtual divestitures. If the required analysis shows that the merger's harm to competition has not been sufficiently mitigated, then the Applicants must propose additional mitigation. (Id., pages 4-5; FERC Order at pages 74-75).

In view of the FERC Order, which reserves to a later time the ultimate approval of the mitigation plan outlined in the Proposed Merger, based upon the outcome of the actual divestiture activities undertaken by the Applicants, Ms. Frayer concluded that this Commission should similarly postpone its final approval of the mitigation plan for the Proposed Merger pending the outcome of such divestitures. Id., page 6).

3. Applicants' Failure To Meet Their Burden of Proof

Any final determination by the Commission in this proceeding could impact the prices and terms of, and other market conditions affecting, future POLR supplies upon which the FirstEnergy Companies and other Pennsylvania utilities will rely in order to meet their retail POLR obligations. Yet, the Applicants would ask this Commission to make its decision in a vacuum. Without the completion, evaluation and adjudication of the further steps required under the FERC Order, this Commission is simply in no position to render a judgment about the Proposed Merger's impact on retail competition.

Pursuant to the Electric Competition Act, the Applicants were required to establish a market power mitigation plan sufficient to permit the Commission to discharge its obligation to preserve Pennsylvania's competitive retail electricity market. The Applicants have not met that burden. The reasonableness and sufficiency of the only plan they have offered remains unresolved.

C. Directed Questions

The Commission directed that certain questions be answered by each party to this proceeding. Answers were provided in the supplemental testimony of W. D. Byrd (Met-Ed/Penelec/ Penn Power Statement No. 1-S-1), and are attached as Appendix B to this Main Brief.

IV. Conclusion

For the reasons set forth in this Main Brief, the FirstEnergy Companies respectfully submit that the Applicants' Proposed Merger cannot be approved by the Commission at this time. The specific relief sought by the FirstEnergy Companies is contained in Appendix A, attached to this Main Brief.

Respectfully submitted,

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SPECIFIC RELIEF SOUGHT BY THE FIRSTENERGY COMPANIES

I. Proposed Findings of Fact

A. Market Impact of the Proposed Merger

1. Met-Ed, Penelec and Penn Power are Pennsylvania electric utilities that supply retail electric distribution service and POLR service to consumers representing over 22% of Pennsylvania's electricity demand. (See e.g., Met-Ed/Penelec/Penn Power Statement No. 3, pages 8-10 and Appendix B).

2. The Applicants' expert witness on competition (Dr. Hieronymus) admitted that the Proposed Merger, absent sufficient mitigation, would raise serious market power issues. (PECO Statement No. 3, page 3).

3. Electricity suppliers which enter into transactions in a marketplace which is structurally characterized by some participants having the potential for the exercise of market power will perceive this as a risk exposure; and, either incorporate this risk premium into their prices or require contractual terms which allocate the risks to the purchasing utilities. (Met-Ed/Penelec/Penn Power Statement No. 1, page 8).

4. The Proposed Merger will result in increased concentration in the various wholesale markets on which Met-Ed, Penelec and Penn Power will rely in meeting their POLR obligations, creating the potential for the exercise of market power which could translate into embedded, higher risk premiums in the prices at which future power supplies will be made available to the utilities. (Met-Ed/Penelec/Penn Power Statement No. 1, pages 4, 8).

5. Whatever the level of future electricity prices, the Proposed Merger would result in prices incrementally higher than they would have been absent the merger, due to the increased concentration of supply and the increased perceptions of the ability for the merged entity to exercise market power. (Met-Ed/Penelec/Penn Power Statement No. 1, page 9).

6. Under a fully deregulated market structure, any impact that increased market power has on regional wholesale price developments will flow through to retail electricity consumers. (Met-Ed/Penelec/Penn Power Statement No. 3, pages 4-5).

7. High wholesale electricity prices that translate into high retail prices will be exacerbated by a concentration of generating assets. (Met-Ed/Penelec/Penn Power Statement No. 2, page 10).

8. Fixed generation rates in Pennsylvania have dampened the potential for full-fledged retail electricity competition in many service territories in Pennsylvania, and have insulated POLR ratepayers from the actual cost of electricity in the wholesale market. (Met-Ed/Penelec/Penn Power Statement No. 1, page 4; Met-Ed/Penelec/Penn Power Statement No. 3, pages 10-12).

9. As generation rate caps expire over the next five years, POLR service pricing will be recalibrated based on then future wholesale market conditions. (Met-Ed/Penelec/Penn Power Statement No. 1, page 4; Met-Ed/Penelec/Penn Power Statement No. 3, pages 10-12).

10. Any final determination on the Proposed Merger by the Commission in this proceeding could impact the prices and terms of, and other market conditions

affecting, future POLR supplies upon which the FirstEnergy Companies and other Pennsylvania utilities will rely in order to meet retail POLR obligations. (See all references above.)

11. Results of recent auctions in Ohio and New Jersey suggest that retail POLR customers are likely to be confronted with prices well in excess of existing price caps. (Met-Ed/Penelec/Penn Power Statement No. 1, page 7).

12. Met-Ed/Penelec Exhibits RAD-1 through RAD-3 demonstrate that the costs of supplying energy and capacity have been steadily rising while rates have remained fixed.

13. Given the current level of gas and coal prices, and the forecasts for these fuels for the next few years, it is unlikely that we will see a significant drop in electricity prices over the short term. (Met-Ed/Penelec/Penn Power Statement No. 3, page 12).

14. A price shock is possible if the post-transition pricing continues to escalate and, particularly, if potential market power is left unchecked. (Met-Ed/Penelec/Penn Power Statement No. 3, page 12).

15. If the Applicants' potential market power is not fully mitigated, Pennsylvania customers coming off generation rate caps may face higher retail prices (as a result of wholesale market conditions) than they would have had to endure if the merger had not occurred. (Met-Ed/Penelec/Penn Power Statement No. 3, pages 12-13).

B. Applicants' Market Power Mitigation Plan

16. The Applicants' market competition expert, Dr. Hieronymus, based his opinions expressed in this Commission proceeding on his analyses conducted for purposes of the FERC's proceeding with respect to the Proposed Merger. (PECO Statement No. 3, page 2; Exhibit WHH-1; PECO Statement No. 3-R, pages 1-4).

17. In concluding that the Proposed Merger will not have adverse effects on retail electric competition Dr. Hieronymus has assumed the adequacy of the Applicants' market power mitigation plan. (PECO Statement No. 1, page 9; Exhibit WHH-1, page 3).

18. The FirstEnergy Companies' expert witness, Ms. Frayer, conducted a thorough review of the analyses and conclusions presented on behalf of the Applicants by Dr. Hieronymus, also conducted an independent analysis of the market power potential resulting from the Proposed Merger, and evaluated the Applicants' market power mitigation plan in the context of these analyses. (Met-Ed/Penelec/Penn Power Statement No. 3, page 15-16).

19. Dr. Hieronymus has admitted, as part of his rebuttal testimony in this Commission proceeding, that further analyses at the FERC might demonstrate that there are lingering market power concerns. (PECO Statement No. 3-R, pages 2-3).

20. The Applicants' own evidence reveals uncertainty as to whether the market power mitigation plan offered by the Applicants would adequately address what has been admitted to be serious market power issues related to the Proposed Merger. (PECO Statement No. 3, page 3; PECO Statement No. 3-R, pages 2-3).

21. Given the magnitude of the post-merger market power that will result from the Proposed Merger, the mitigation plan offered by the Applicants is insufficient. (Met-Ed/Penelec/Penn Power Statement No. 3, page 16).

C. Joint Petition for Settlement

22. FirstEnergy's market power issues have not been specifically addressed by the Joint Petition for Settlement filed on September 13, 2005 on behalf of the Applicants and a number of other parties. (Stipulation Regarding Market Power Issues among the Applicants and the FirstEnergy Companies filed on September 22, 2005).

D. FERC Order¹

23. The Applicants must complete further analyses at the FERC before that agency is prepared to sign off on the competitive effects of the Proposed Merger. (Met-Ed/Penelec/Penn Power Statement No. 1-S-1, page 10; 3-S, Met-Ed/Penelec/Penn Power Statement No. 3-S, pages 2-5; PECO Statement No. 3-R, pages 2-3; FERC Order, ordering paragraph (G)).

24. The Applicants are required to make a compliance filing to the FERC within 30 days of the completion of their divestiture, providing a complete analysis of the merger's effect on competition in energy and capacity markets, given actual plants divested and the actual acquirers of the divested assets and energy contracts from virtual divestitures. If the required analysis shows that the merger's harm to competition has not been sufficiently mitigated, then the Applicants must propose

¹ Docket No. EC05-43-000, Order of July 1, 2005, 112 FERC ¶ 61,011 (2005).

additional mitigation. (Met-Ed/Penelec/Penn Power Statement No. 3-S, pages 4-5; FERC Order at pages 74-75).

25. Dr. Hieronymus has continued to recommend that this Commission approve the merger unconditionally, without the benefit of any further review *as required* by the FERC Order. (PECO Statement No. 3-R, page 3).

26. In view of the FERC Order, which reserves to a later time the ultimate approval of the mitigation plan outlined in the Proposed Merger, based upon the outcome of the actual divestiture activities undertaken by the Applicants, Ms. Frayer concluded that this Commission should similarly postpone its final approval of the mitigation plan for the Proposed Merger pending the outcome of such divestitures. (Met-Ed/Penelec/Penn Power Statement No. 3-S, page 6).

27. The result of this Commission accepting the recommendation of Dr. Hieronymus would be that this Commission would approve the competitive impacts of a merger that as yet has not been finally approved at FERC. (See references above.)

II. Proposed Conclusions of Law

A. Electric Competition Act Applicability

1. The Commission is required by the Electric Competition Act to consider the Proposed Merger's anticompetitive effects and possible adverse impacts on Pennsylvania's competitive retail electricity market. (66 Pa. C.S. § 2811).

2. It is the Commission's obligation to ensure that the Applicants' post-merger market power and the anticompetitive effects of the Proposed Merger will be adequately mitigated. (66 Pa. C.S. § 2811).

B. General Commission Authority re Merger Approval

3. The Commission's statutory authority and obligations under this portion of the Electric Competition Act are consistent with its general authority to approve mergers if they are proven to be " necessary or proper for the service, accommodation, convenience, or safety of the public." (66 Pa. C.S. § 1103(a); York v. Pennsylvania Public Utility Commission, 449 Pa. 136, 295 A.2d 825 (1972)).

4. It is also well-established that, in deciding whether a proposed merger is in the public interest, the Commission "may impose such conditions as it may deem to be just and reasonable." (66 Pa. C.S. § 1103(a)).

C. Applicants Bear Burden of Proof

5. Pennsylvania Public Utility Code Section 332(a) sets forth the general rule with respect to burden of proof in proceedings before this Commission. (66 Pa. C.S. § 332(a)).

6. As the parties seeking a rule or order from this Commission, the Applicants bear the ultimate burden of persuading the Commission, by a preponderance of substantial evidence, that the relief sought is proper and justified under the circumstances. (Se-Ling Hosiery v. Margulies, 70 A.2d 854 (Pa. 1954)).

7. The Applicants bear the burden of proof, in this Commission proceeding, to establish that the proposed market power mitigation plan they have offered is sufficient to remedy the admitted adverse market power consequences of the Proposed Merger. (66 Pa. C.S. § 2811(e); 66 Pa. C.S. § 1103(a)).

D. Substantial Evidence Required

8. The Commission's decision must be supported by substantial evidence in the record – i.e., relevant evidence that a reasonable mind may accept as adequate to support a conclusion: more is required than a mere trace of evidence or a suspicion of the existence of a fact sought to be established. (See e.g., Section 704 of the Administrative Agency Law, 2 Pa. C.S. § 704; Yellow Cab Company v. Pa.P.U.C., 524 A.2d 1069 (Pa. Cmwlth. 1987); Murphy v. PA Department of Public Welfare, White Haven Center, 480 A.2d 382 (Pa. Cmwlth. 1984); Erie Resistor Corp. v. Unemployment Comp. Bd. of Review, 166 A.2d 96 (Pa. Super. 1961)).

E. Conclusions re Applicants' Case

9. Absent a final plan sufficient to mitigate market power consequences of the Proposed Merger, the Proposed Merger is likely to have a material adverse impact on the competitive retail electricity market in Pennsylvania. (66 Pa. C.S. § 2811(e)).

10. The Applicants have not provided the Commission with a substantial evidentiary basis from which to conclude that the Applicants' proposed market power mitigation plan is sufficient to remedy the admitted adverse market power consequences of the Proposed Merger. (66 Pa. C.S. § 2811(e)).

11. The FERC Order did not unconditionally "approve" the Proposed Merger. FERC Order, pages 74-75 and ordering paragraph (G).

12. The FERC Order did not reject the need for further market power analyses of the Proposed Merger. (FERC Order, pages 74-75 and ordering paragraph (G)).

13. The FERC Order has concluded that the Proposed Merger's impact on competition cannot be determined until some future date at which the Applicants' specific divestiture plans become known. (FERC Order, pages 74-75 and ordering paragraph (G)).

14. The FERC has retained the right to order additional mitigation if the Applicants' divestiture plans prove to be inadequate. (FERC Order, pages 74-75 and ordering paragraph (G)).

15. Pursuant to the Electric Competition Act, the Applicants were required to establish a market power mitigation plan sufficient to permit the Commission to discharge its obligation to preserve Pennsylvania's competitive retail electricity market. The Applicants have not met that burden. The reasonableness and sufficiency of the only plan they have offered remains unresolved. The Commission cannot approve the Proposed Merger in such a vacuum. (See references above).

III. Proposed Ordering Paragraphs

It is respectfully requested that the ALJ, and the Commission, enter the following ordering paragraphs:

1. The Applicants have not met their burden of proof in this proceeding, being unable to demonstrate through substantial evidence of record that their proposed market power mitigation plan is sufficient to remedy the admitted adverse market power consequences of the Proposed Merger, which threaten the competitive retail electricity market in Pennsylvania; therefore,

2. The Proposed Merger cannot be approved at this time.

APPENDIX B

The Commission directed that certain questions be answered by each party to this proceeding. The FirstEnergy Companies' answers, below, were provided in the Supplemental Testimony of W. D. Byrd (Met-Ed/Penelec/ Penn Power Statement No. 1-S-1).

- Q. “1. Neighboring states have availed themselves of opportunities to enhance their economic competitiveness through access to economic energy resources. What opportunities exist from this proposed merger in terms of economic development for Pennsylvania? Specifically, does this proposed merger present us [this Commission] with an opportunity to strengthen the State’s ability to remain competitive during periods of economic recession and volatile energy pricing?”**
- A. Unfortunately, I believe this merger as proposed, in particular the limited mitigation plan that has been proposed, will impede the development of a robust competitive retail market. Both I and Ms. Julia Frayer, FirstEnergy Companies’ independent expert consultant, have outlined the difficulties from the FirstEnergy Companies’ perspective with the market power mitigation plan committed to by the Applicants. As I pointed out in my direct testimony, the very existence of the merger, with the size of the utilities involved, will have a chilling effect on competitive electricity pricing.

As capped or frozen rates begin to expire for Pennsylvania retail electricity customers, they will be exposed to the market prices of electricity, which are likely to be significantly higher than Pennsylvania's retail customers were accustomed to under fixed rates. The dynamics of the wholesale electricity market will be reflected in the prices paid by retail customers. As an example, I pointed out in my direct testimony that the FirstEnergy utilities' recent auctions in Ohio and New Jersey resulted in pricing that is well in excess of prices paid today by Pennsylvania's FirstEnergy retail customers under fixed rates.

The Applicants' proposed merger will result in increased concentration in the various wholesale markets in which the FirstEnergy Companies and other Pennsylvania electric utilities must secure power supplies, in particular to fulfill their provider-of-last-resort ("POLR") obligations. This increased concentration creates the potential for the exercise of market power. Such potential, in fact, will translate into embedded, higher risk premiums in the prices at which future power supplies will be made available. Electricity generation suppliers will seek to be adequately compensated for the risks they perceive they will be incurring by entering into supply arrangements for POLR service. Participants which enter into transactions in a marketplace which is characterized by some participants having the potential for the exercise of market power will perceive this as a risk exposure and either incorporate this risk premium into their prices or will require contractual terms which allocate the risks to the utilities. Either way, POLR customers will ultimately pay a higher price than otherwise. In my direct

testimony, I pointed out the example of the well publicized exercise of market power in the daily capacity market in PJM in 2001, which resulted in rule changes within PJM hopefully to prevent a re-occurrence. Subsequently, term capacity transactions in the PJM market continue to reflect a “rules” premium. Market power, once demonstrated, has had a long-term, lingering effect on capacity prices in PJM.

My point is not that future electricity prices will necessarily be higher than historical levels. I am not offering an opinion on the future level of electricity prices, which will be determined by a variety of factors including, but not limited to, fuel prices, institutional structures within which the industry operates, economic growth, environmental rules and laws, transmission investment and other factors. What is of concern to the FirstEnergy Companies related to Applicants’ proposed merger is that, whatever the level of future prices, the merger will result in prices incrementally higher than they would have been absent the merger, due to the increased concentration of supply and the increased perceptions of the ability for the merged entity to exercise market power.

Q. “2. The innovative and controversial nuclear “virtual divestiture” component of the FERC decision appears to present intriguing opportunities for the Commonwealth. Does the proposed merger present this Commission with an opportunity to create an additional economic development program designed to improve Pennsylvania’s business climate by creating strategic

partnerships with the public and private sector that support product development and the use of energy-efficient technologies?”

- A. It is difficult to see how the Applicants’ virtual divestiture proposal would achieve this objective. It is clear that the Applicants’ proposal to sell the output of certain its nuclear plants is designed to occur at market prices. For example, to the extent an auction process is used to implement virtual divestiture, the Applicants propose an ascending clock, multiple-round auction. While the precise mechanics of Applicants’ virtual divestiture proposal have yet to be revealed, it appears that these sales will occur at market prices. These market prices may very well exceed the generation prices implicit in the FirstEnergy Companies’ existing retail rates.

Accordingly, as I indicated above and in my direct testimony in this proceeding, I believe the merger as proposed, with no further market power mitigation efforts by the Applicants, will on balance deprive Pennsylvania of potential opportunities for further economic development and an enhance business climate. The primary concern of customers is price. As POLR rates begin to reflect true market prices, the current projections indicate that retail customers will see increases, not decrease, in pricing. The proposed merger will not contribute to lower market prices, and could result in higher market prices.

- Q. **“3. Would it be possible to set aside 10% or some relatively small share of the “virtually” divested generation to augment economic development and economic competition with the Commonwealth? For example, could the**

parties consider and comment on creating a pool of energy and capacity of at least 260 MWs which could be used at the discretion of the Secretary of the Department of Community and Economic Development to attract and retain business in the Commonwealth?"

- A. The concept suggested by the question is highly problematic. First, setting aside a percentage of divested generation is not currently a part of the Applicants' proposal, and presumably would require their consent, as well as subsequent approval by the Federal Energy Regulatory Commission as part of the Applicants' compliance plan.

Moreover, setting aside this pool of low cost energy would impact market prices. If electric generation service is to be truly price competitive, such an artificial limit to market availability should be discouraged. Although I am not a lawyer, as *someone who is familiar with regulatory requirements impacting electric generation* I also would question whether, or the extent to which, such arrangements would be consistent with or permitted under the Electricity Generation Customer Choice and Competition Act.

In addition, the selection of winners and losers among Pennsylvania business and industry consumers in terms of gaining access to the prescribed portion of energy and capacity would be a constant source of debate and litigation. This selection process would of necessity involve a selection of one or more distribution utilities' service areas over others. Businesses and industries across the service

areas of Pennsylvania's distribution utilities deserve equal access to the "best" deals available for acquiring electric generation service. Unavoidable inequities among distribution utility service providers, due to geography or transmissions constraints, could compromise the ability of businesses or industries to acquire competitive electricity generation sources.

Q. "4. Could the Commonwealth through one of its agencies and/or in conjunction with a licensed Electric Generation Supplier facilitate the use of the output of this generation?"

A. This suggestion has the same problems as expressed above. In addition, putting the Commonwealth or an EGS provider in the position of picking winners and losers would cause significant problems in administering an open and competitive retail electricity generation market.

If the Commonwealth of Pennsylvania desires to encourage a broad diversity and base of generation sources, it would be better served to provide tax credits to developers of projects that meet various Commonwealth policy goals, and leave the actual sale of power to the marketplace. This alternative legislation could be structured so as to be consistent with the current policy goal of encouraging a competitively priced, and unregulated, electricity generation market.

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Joint Application of PECO Energy :
Company and Public Service Electric :
and Gas Company for Approval of : Docket No. A-110550F0160
the Merger of Public Service Enterprise :
Group Incorporated with and into Exelon :
Corporation :

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I hereby certify that I have this day served copies of FirstEnergy Companies' Main Brief upon the persons and in the manner indicated below in accordance with the requirements of 52 Pa. Code § 1.54.

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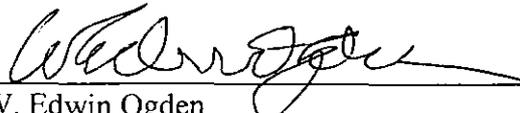
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October 14, 2005

Reply to Philadelphia Office

James J. McNulty, Secretary
Pennsylvania Public Utility Commission
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ORIGINAL

Re: In the Matter of the Joint Application of PECO Energy Company and
Public Service Electric and Gas Company for Approval of the Merger of
Public Service Enterprise Group with and into Exelon Corporation
Docket No. A-110550F0160

Dear Secretary McNulty:

Enclosed please find an original and nine copies of the Main Brief of the
PennFuture Parties in the above-captioned proceeding. Copies have been served on the
parties as set forth in the Certificate of Service.

DOCUMENT
FOLDER

Sincerely,

Charles McPhedran
Senior Attorney

cc: Hon. Marlane R. Chestnut
Certificate of Service

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OCT 14 2005

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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

JOINT APPLICATION OF PECO :
ENERGY COMPANY AND PUBLIC : DOCKET NO. A-110550F0160
SERVICE ELECTRIC AND GAS :
COMPANY FOR APPROVAL OF THE :
MERGER OF PUBLIC SERVICE :
ENTERPRISE GROUP WITH AND :
INTO EXELON CORPORATION :

MAIN BRIEF OF THE PENNFUTURE PARTIES

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PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

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October 14, 2005

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I. Summary of the Case

On February 4, 2005, PECO Energy Company (PECO) and Public Service Enterprise and Gas Company (PSE&G) filed a Joint Application seeking approval by the Pennsylvania Public Utility Commission of the merger of PSEG, the corporate parent of PSE&G, with and into PECO's ultimate parent, Exelon Corporation. On March 4, 2005, Citizens for Pennsylvania's Future (PennFuture), Joy Bergey, and Lisa Z. Leighton (collectively, the PennFuture Parties) filed a Protest and Petition to Intervene in this proceeding, which the Administrative Law Judge granted by Order dated March 30, 2005.

On September 12, 2005, 12 parties to the proceeding filed a Joint Petition for Settlement (Joint Petition). The Joint Petition represents a comprehensive settlement among these parties. The PennFuture Parties signed the Joint Petition and file this Main Brief in support thereof.

II. Statement of Question Involved

Where a proposed settlement in a merger proceeding is in the public interest and offers affirmative benefits in many regards, including but not limited to renewable energy, energy efficiency, and net metering/interconnection, should the Commission approve the settlement?

The PennFuture Parties suggest an answer in the affirmative.

III. Argument

- A. The Joint Petition demonstrates substantial affirmative benefits to the public under applicable standards.

To approve a merger, the Commission must find affirmatively that it will lead to public benefit, and the proponents of a merger must "demonstrate that the merger will

affirmatively promote the 'service accommodation, convenience or safety of the public' in some substantial way." City of York v. Pa. P.U.C., 449 Pa. 136, 141, 295 A.2d 825, 828 (1972)(citation omitted). The Commission may impose such conditions on mergers as it deems just and reasonable. 66 Pa.C.S. § 1103(a). The Joint Petition in this matter demonstrates substantial affirmative benefits to the public, including rate reductions, reliability improvements, assistance for low-income customers, economic development, increased energy conservation and more clean energy supply. See Joint Petition, generally.

In particular, the Joint Petition includes requirements that will provide affirmative benefits to the public by funding and encouraging renewable energy and energy efficiency. Under the Joint Petition, PECO has agreed to contribute \$12.0 million over four years to the Pennsylvania Energy Development Authority "to be used for the purposes of funding renewable energy, energy efficiency and energy conservation projects with emphasis on energy conservation projects of benefit to the PECO service territory." Joint Petition at 23. Additionally, PECO has agreed to provide \$7.2 million in a lump sum payment to the Sustainable Development Fund, which finances projects that promote renewable energy and energy efficiency. Joint Petition at 23; TRF St. No. 1 at 25 (Exhibit LMM-2).

Further, the Joint Petition provides the following with regard to net metering and interconnection rules:

PECO will adopt net metering and interconnection rules that are materially consistent with safe utility practice and the corresponding rules currently in place in New Jersey unless the Commission, as part of its ongoing Alternative Energy Portfolio Standards ("AEPS") rulemaking proceeding at Docket No. M-00051865, adopts statewide net metering and interconnection rules that are inconsistent with the New Jersey rules.

Joint Petition at 24.

The total of \$19.2 million for renewable energy and energy efficiency projects offers significant affirmative benefits to the public. Among other things, clean, renewable energy improves distribution system reliability and reduces system congestion; provides jobs and economic development; offers a domestic and secure energy supply; and reduces air pollution and its health impacts. PF St. No. 1 at 5; TRF St. No. 1 at 5, 7-9. The benefits of energy efficiency include reduced load on the transmission and distribution system and financial savings for Pennsylvania households and business. DEP St. No. 3 at 6-7; PF St. No. 2 at 6.

The improvements in PECO's net metering and interconnection rules provided by the settlement agreement will also offer significant affirmative benefits to the public by facilitating the development of renewable distributed energy generation. Because net metering and interconnection rules in New Jersey lower the barriers to distributed generation as compared to Pennsylvania, the adoption of New Jersey rules by PECO will encourage distributed renewable generation capacity, which will offer the significant benefits of renewable energy cited above. PF St. No. 3 at 3.

B. Objections to the Joint Petition fail to recognize its affirmative benefits.

The City of Philadelphia has urged the Commission to reject the proposed merger "if the terms are to be solely those outlined in the Joint Petition for Settlement", characterizing the benefits offered by the Joint Petition as "insufficient". Statement of the City of Philadelphia in Opposition to Approval of Merger Based Solely on Terms of Settlement at 1. Regarding renewable energy, energy efficiency, and related provisions of the Joint Petition, the City of Philadelphia states:

PECO proposes to make a modest short-term contribution to PEDA, which may use up to 95% of the funds outside the PECO service territory, and an even more modest one-time contribution to the Sustainable Development Fund. The net metering and interconnection commitment is meaningless unless the Commission agrees in a separate proceeding--in which case PECO would have had to comply irrespective of the merger or Settlement.

Statement of the City of Philadelphia at 4 (footnote omitted). The City of Philadelphia characterizes the payments in support of renewable energy and energy efficiency as "modest" without mentioning the dollar amounts: \$12 million to PEDA and \$7.2 million to SDF. In fact, these funds will support substantial new clean energy development in the Commonwealth that will provide affirmative benefits consistent with the testimony submitted in this proceeding by the Pennsylvania Department of Environmental Protection, the PennFuture Parties and The Reinvestment Fund. Further, the City of Philadelphia misreads the settlement provision regarding net metering and interconnection. Set forth in full above (p. 2), this provision in fact requires PECO to adopt New Jersey-style rules unless the Commission adopts statewide rules that are inconsistent with New Jersey rules. Joint Petition at 24. Contrary to the description by the City of Philadelphia, PECO will be bound by the Joint Petition to move forward on net metering and interconnection if the Commission does not act. This is a significant commitment by PECO that will offer substantial affirmative benefits offered to the public in the form of renewable distributed energy generation. PF St. No. 3 at 3.

Philadelphia Gas Works submitted supplemental testimony in opposition to the Joint Petition. PGW St. No. 1-S. This testimony did not attempt to refute the affirmative benefits offered by renewable energy, energy efficiency, and net metering/interconnection provisions of the decree.

Both the City of Philadelphia and Philadelphia Gas Works fail to recognize the significant affirmative benefits offered by renewable energy, energy efficiency, and net metering/interconnection and described in testimony offered by the Pennsylvania Department of Environmental Protection (DEP St. No. 3), the PennFuture Parties (PF St. Nos. 1, 2, and 3), and The Reinvestment Fund (TRF St. No. 1). The failure of these Philadelphia parties to recognize the benefits of these programs is unfortunate given the creation of new renewable energy jobs in Philadelphia and the potential for air quality improvements and reduced health costs in the Philadelphia area. PF St. No. 1 at 6. For these reasons, the Commission should set aside these objections to the settlement insofar as they fail to recognize significant affirmative benefits to the public from the renewable energy, energy efficiency, and net metering/interconnection provisions of the Joint Petition.

IV. Proposed Findings of Fact

1. The benefits of clean, renewable energy include, among other things, improvements to distribution system reliability, fuel diversity to protect ratepayers from escalating fuel prices, reduction in system congestion, new jobs and economic development, reduced dependence on foreign energy sources, and reduced pollution. PF St. No. 1 at 5; TRF St. No. 1 at 5, 7-9.

2. The benefits of energy efficiency include but are not limited to reduced load on the transmission and distribution system and financial savings for Pennsylvania households and business. DEP St. No. 3 at 6-7; PF St. No. 2 at 6 (see also benefits of "clean energy" generally, which includes energy efficiency, at TRF St. No. 1 at 7-9).

3. The adoption of New Jersey procedures for net metering and interconnection in Pennsylvania offers significant benefits by encouraging the development of distributed renewable energy resources. PF St. No. 3 at 3.

4. Under the settlement proposed by the Joint Petition, PECO agrees to contribute \$12 million to the Pennsylvania Energy Development Authority to be used for the purposes of funding renewable energy, energy efficiency, and energy conservation projects with emphasis on energy conservation projects of benefit to the PECO service territory. Joint Petition at 23.

5. Under the settlement proposed by the Joint Petition, PECO agrees to provide \$7.2 million to the Sustainable Development Fund within three months after consummation of the merger. Joint Petition at 23-24.

6. The Sustainable Development Fund finances companies and projects in southeastern Pennsylvania that involve renewable energy, advanced clean energy, and energy efficiency technologies. TRF St. No. 1 at 25 (Exhibit LMM-2).

7. Under the settlement proposed by the Joint Petition, PECO will adopt net metering and interconnection rules that are materially consistent with safe utility practice and the corresponding rules currently in place in New Jersey unless the Commission, as part of its ongoing Alternative Energy Portfolio Standards ("AEPS") rulemaking proceeding at Docket No. M-00051865, adopts statewide net metering and interconnection rules that are inconsistent with the New Jersey rules. Joint Petition at 24.

V. Proposed Conclusion of Law

1. The settlement proposed by the Joint Petition, including but not limited to its provisions regarding energy efficiency, renewable energy, and net

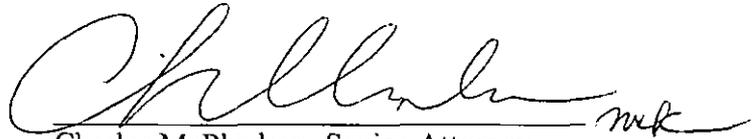
metering/interconnection, provides affirmative benefits under applicable precedent, including City of York v. Pa. P.U.C. 449 Pa. 136, 295 A.2d 825 (1972).

VI. Conclusion

For the foregoing reasons, the PennFuture Parties urge approval of the Joint Petition for Settlement as offering substantial affirmative benefits to the public.

FOR THE PENNFUTURE PARTIES

Respectfully submitted,

A handwritten signature in cursive script, appearing to read 'C. McPhedran', with a small 'm' and 'f' at the end.

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